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August 8, 2012

The Honorable Patrick Quinn
Governor
State of Illinois
207 Statehouse
Springfield, IL 62706

Dear Governor Quinn:

With the recent push to address pension reform in the special session of the General Assembly scheduled for August 17, 2012, I thought it would make sense to write you to explain the Civic Committee's position on HB1447, which is currently being considered for approval by the House of Representatives. We strongly believe, as I think you do, that the pension system – the benefits that have been accrued for current retirees and employees and their growing demands on the state's finances – is the key issue facing the State of Illinois. Clearly, the longer the time elapses, the greater the liability and demands on state revenues.

As I have indicated in our various discussions and in the documents that we provided in response to drafts of legislation during the spring, we believe the following concerns will need to be addressed to ensure pension reform is meaningful and lasting:

1) All of the state systems should be included in any reform proposal (excepting judges if that is the view of leadership). Under HB1447, the Teachers Retirement System (TRS) and State Universities Retirement System (SURS), which represent approximately 75% of the pension system liabilities, are not included in the bill. Our belief is that omitting them from any reform proposal hurts the state and the pension participants in the future, especially if the issue is litigated. One view is to wait to reform the other systems until HB1447 is challenged in the courts. By that time, the liabilities will have dramatically increased and the demands on the state budget will have continued to mount. We firmly believe that it would be better to send a bill which includes all the systems to the Court. Should the court find any part of it legally or constitutionally objectionable, they would necessarily explain what and why. Any such objection could then readily be handled by the General Assembly in following legislation, and Illinois can move beyond our present and devastating condition.

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2) Moody's rating agency, as well as GASB, is expected to implement new ways of looking at public pension systems nationwide. While their approaches are somewhat similar, the Moody's methodology, which is expected to be implemented shortly after they finish taking public comment on August 31, 2012, will include the following: 1) Changing the way liabilities are discounted based on the high grade long-term corporate bond index discount rate (e.g. 5.5% for 2010 and 2011); 2) Recalculating the annual pension contributions that entities should make based on these changes, as well as a standard amortization period and methodology; 3) Replacing "smoothed" asset values with market–based values; and 4) Allocating costs of multiple employer cost sharing plans to individual employers. While it is unclear whether the public comments will bring any changes in their suggested methodology, the basic scorecard as currently contemplated will show that the reforms that are currently stipulated in HB1447 are far from sufficient to address the true nature of the pension obligations. According to Moody's, the change in discount rate will lead to a 13% increase in the total liability for every 1% reduction in discount rate, which will have a dramatic impact on both the unfunded liability and the amount that will be needed to amortize the unfunded liability (given that Illinois currently has a blended discount rate of 8.2%). While the Moody's approach doesn't change the actual amount of the state's pension benefit payouts each year, it will spotlight the shortcomings of the pension system for participants and stakeholders alike and could have a significant financial consequence by increasing the cost of state borrowing.

3) We continue to have concerns about the notion of consideration and its implementation in HB1447, particularly the trade of access to retiree health care for pension reforms. While I have always indicated that we do not agree as to the necessity of such consideration as articulated, I have come to believe (which I agree is a change) that the nature of the way the bill is structured could in essence be converting retiree health care into some sort of constitutionally protected benefit, by trading what some perceive as a constitutional protection for the pension benefit with what is not a protected retiree health care benefit. The result would be to worsen, not improve the state's condition regarding the escalation of the cost of retirement benefits. We appreciate all that Eric Madier has done to try to make the bill constitutionally palatable – but I have now come to believe that such a trade could put us in an even more tenuous financial situation.

4) Given all of the above and the passage of time, neither HB1447 nor SB1673 provide sufficient savings to allow us to support the measures. All of the rating agencies have indicated that a key provision of pension reform includes the significant reduction of our unfunded liability. At their highest amount, these bills would reduce the unfunded pension liability by $17.8 billion (or $11.2 billion at the lower level articulated in the figures provided us by Senator Cullerton). In addition, Illinois currently carries a $55 billion unfunded liability with respect to retiree health care which we believe could be reduced without a constitutional bar as part of the Governor's administrative duties. Under the current structure of these bills, we believe a substantial retiree health care obligation will be locked-in in return for a small reduction in the pension liability. To our knowledge, the potential impact of this has not been enumerated.

As I have indicated previously, it would be a shame to see all of your efforts and those of your colleagues in trying to address the state's retiree obligations fail to result in a sustainable plan. The stakes are too high and the personal and political investment of all involved should not be wasted. The implementation of the upcoming Moody's methodology, especially, will spotlight the shortcomings of the current proposals given that we are 50th in funding in the nation. As I think about this issue, I continue to be nagged by the question "What will be the answer to the new teacher who is putting in 9.4% of her salary and still has little chance of seeing her pension even after reform?" The nature of the kinds of reforms that will be needed to assure the plans are sustainable will have to be far more substantial than those currently proposed and include those similar to what was undertaken in Rhode Island or potentially even more significant reforms. We would welcome the opportunity to discuss these matters further. Sincere thanks for your consideration.

Best,

Tyrone C. Fahner

cc: The Honorable John J. Cullerton
The Honorable Christine Radogno
The Honorable Michael J. Madigan
The Honorable Tom Cross